

# Proposed Tax Law Changes: How Will They Affect You?



presented by

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# A year in flux...

## Build Back Better Act (H.R. 5376)

- The House Ways and Means Committee released its plan to pay for President Biden's Build Back Better Act in September 2021
- House Democrats released revised text in its budget reconciliation bill last week on Thursday, October 28, 2021
- Tax items are not settled – Punchbowl News reported that “the revenue portion of the reconciliation package is still open”

# Proposals Outlined in September, 2021

## Decrease of Federal Estate and Gift Exemption

- Reduction of current \$10 million exemption (indexed for inflation to \$11.7 million for 2021) to \$5 million (indexed for inflation to about \$6.2 million) as of January 1, 2022
- Under current law the \$10 million exemption will revert to \$5 million on January 1, 2026
- Planning opportunity – consider using any remaining gift tax exemption prior to January 1, 2022

# Basic estate and gift tax rules

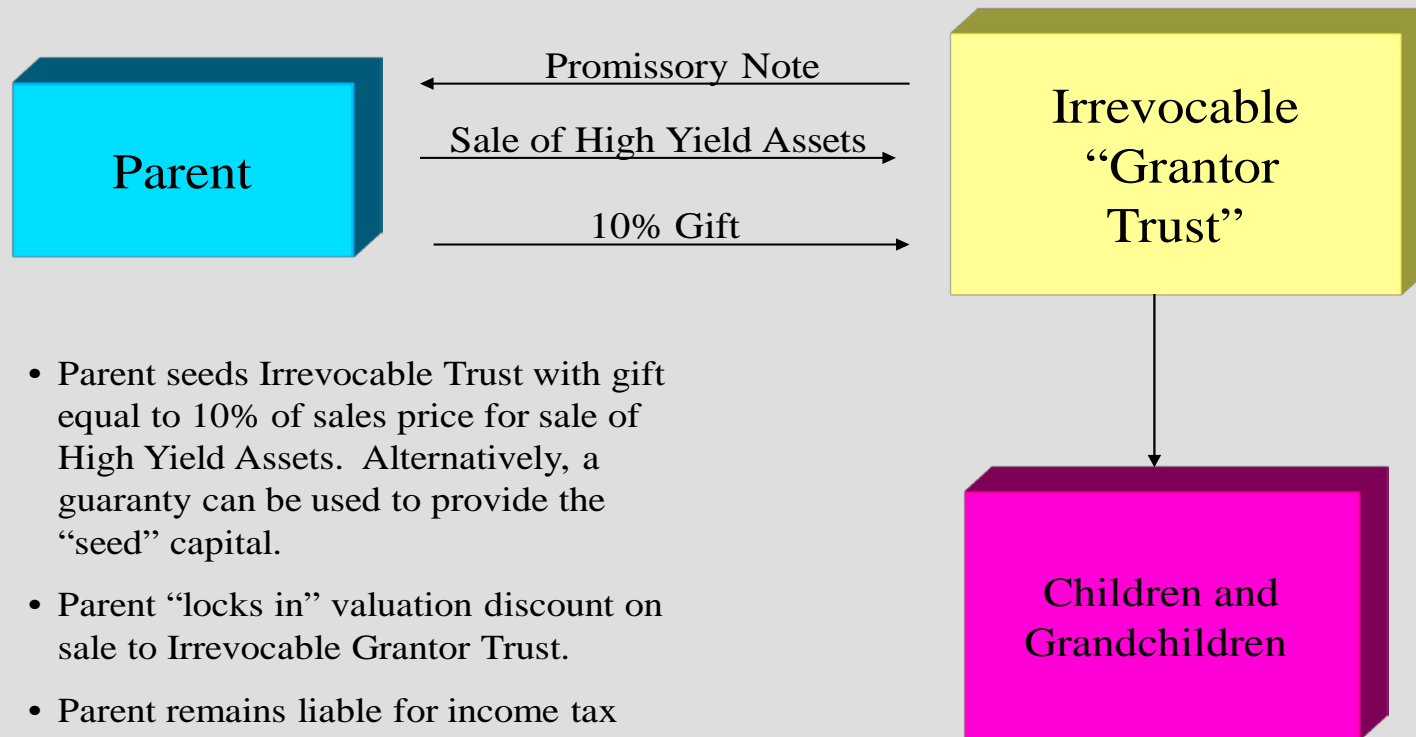
	<u>Lifetime Gift Tax Exemption</u>	<u>Estate Tax Exemption</u>	<u>GST Tax Exemption</u>	<u>Top Transfer Tax Rate</u>
2001	\$ 675,000	\$ 675,000	\$1,060,000	55%
2002	1,000,000	1,000,000	1,100,000	50%
2003	1,000,000	1,000,000	1,120,000	49%
2004	1,000,000	1,500,000	1,500,000	48%
2005	1,000,000	1,500,000	1,500,000	47%
2006	1,000,000	2,000,000	2,000,000	46%
2007	1,000,000	2,000,000	2,000,000	45%
2008	1,000,000	2,000,000	2,000,000	45%
2009	1,000,000	3,500,000	3,500,000	45%
2010	1,000,000	5,000,000	5,000,000	35%
2011	5,000,000	5,000,000	5,000,000	35%
2012	5,120,000	5,120,000	5,120,000	35%
2013	5,250,000	5,250,000	5,250,000	40%
2014	5,340,000	5,340,000	5,340,000	40%
2015	5,430,000	5,430,000	5,430,000	40%
2016	5,450,000	5,450,000	5,450,000	40%
2017	5,490,000	5,490,000	5,490,000	40%
2018	11,180,000	11,180,000	11,180,000	40%
2019	11,400,000	11,400,000	11,400,000	40%
2020	11,580,000	11,580,000	11,580,000	40%
2021	11,700,000	11,700,000	11,700,000	40%

# Proposals Outlined in September, 2021

## Proposed Changes to Grantor Trust Rules

- Major proposed changes would dramatically curtail the ability to use grantor trusts in estate planning
- What is a “grantor trust” (sometimes called an “intentionally defective grantor trust” or “IDGT”)?
  - Irrevocable trust created by grantor that is drafted so that the grantor remains the owner for income tax purposes
  - Allow transactions between a grantor and grantor trust to occur without income tax ramifications, such as sales, loans, leases, etc.
- Also requires grantor to continue paying the income tax for the assets without tax payments being considered additional gifts, which preserves the value of the trust for the beneficiaries

## Sale to Intentionally Defective Grantor Trust



- Parent seeds Irrevocable Trust with gift equal to 10% of sales price for sale of High Yield Assets. Alternatively, a guaranty can be used to provide the “seed” capital.
- Parent “locks in” valuation discount on sale to Irrevocable Grantor Trust.
- Parent remains liable for income tax liabilities of Irrevocable Grantor Trust.
- Promissory Note has fixed interest rate based on the applicable federal rate.

# Proposed Changes to Grantor Trust Rules

## Proposed Legislation

- Would include all assets of a grantor trust in the grantor's estate at death
- Sale transactions between a grantor and grantor trust would be subject to income tax and capital gains would be immediately recognized
- All distributions from grantor trust to beneficiaries other than the grantor or the grantor's spouse would be treated as taxable gifts
- "Turning off" grantor trust status would be a gift to the trust beneficiaries based on value of trust at time of gift

## Proposed Changes to Grantor Trust Rules

- Changes were proposed to apply only to trusts established after date of enactment and any contributions to existing trusts made after date of enactment.
- Concern about retroactive effective date
- Unclear if proposal passes whether grandfathered pre-enactment grantor trusts would incur tax if there are post-enactment transactions (payment of income taxes by grantor, “turning off” grantor trust status, and so forth)

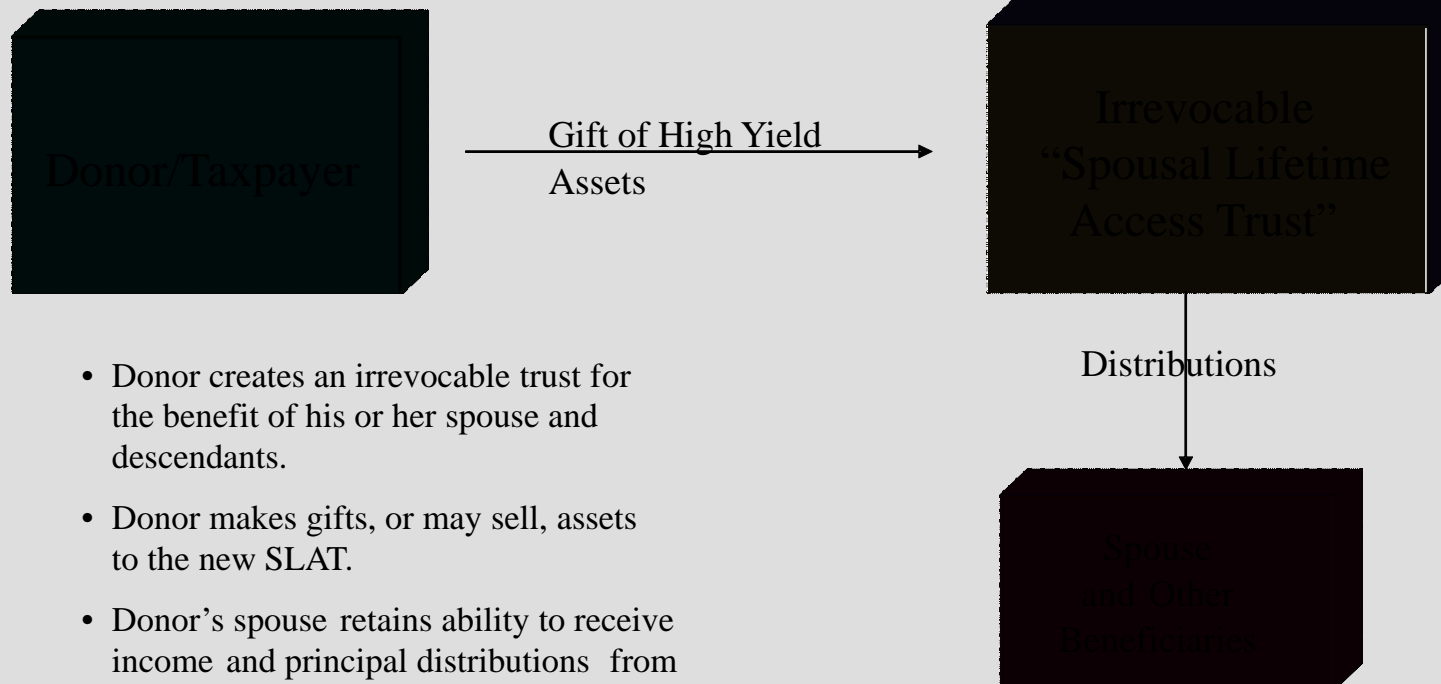


# What Would Changes in Grantor Trust Rules Impact?

## SLATs – Spousal Lifetime Access Trust

- Trust set up by grantor for spouse
- SLATs are almost always automatically grantor trusts because spouse is a primary beneficiary

## Spousal Lifetime Access Trust



- Donor creates an irrevocable trust for the benefit of his or her spouse and descendants.
- Donor makes gifts, or may sell, assets to the new SLAT.
- Donor's spouse retains ability to receive income and principal distributions from the SLAT for his or her lifetime.
- At the spouse's death, the SLAT goes on to descendants and other beneficiaries free of federal estate tax.

# What Would Changes in Grantor Trust Rules Impact?

## Irrevocable Life Insurance Trust (ILITs)

- Irrevocable trust set up to own and be the beneficiary of life insurance on grantor's life that excludes death benefit from grantor's estate
- Most ILITs are grantor trusts – if proposed changes pass, ILIT assets would be included in grantor's estate at death
- Even if grandfathered (pre-enactment) ILITs are excluded, if gift contributions are made to ILIT post-enactment to pay premiums, concern may taint the ILIT and cause some portion of trust to be taxed for estate tax purposes at grantor's death
- Planning Option: Pre-fund insurance premiums before enactment or make existing ILITs non-grantor trusts

# What Would Changes in Grantor Trust Rules Impact?

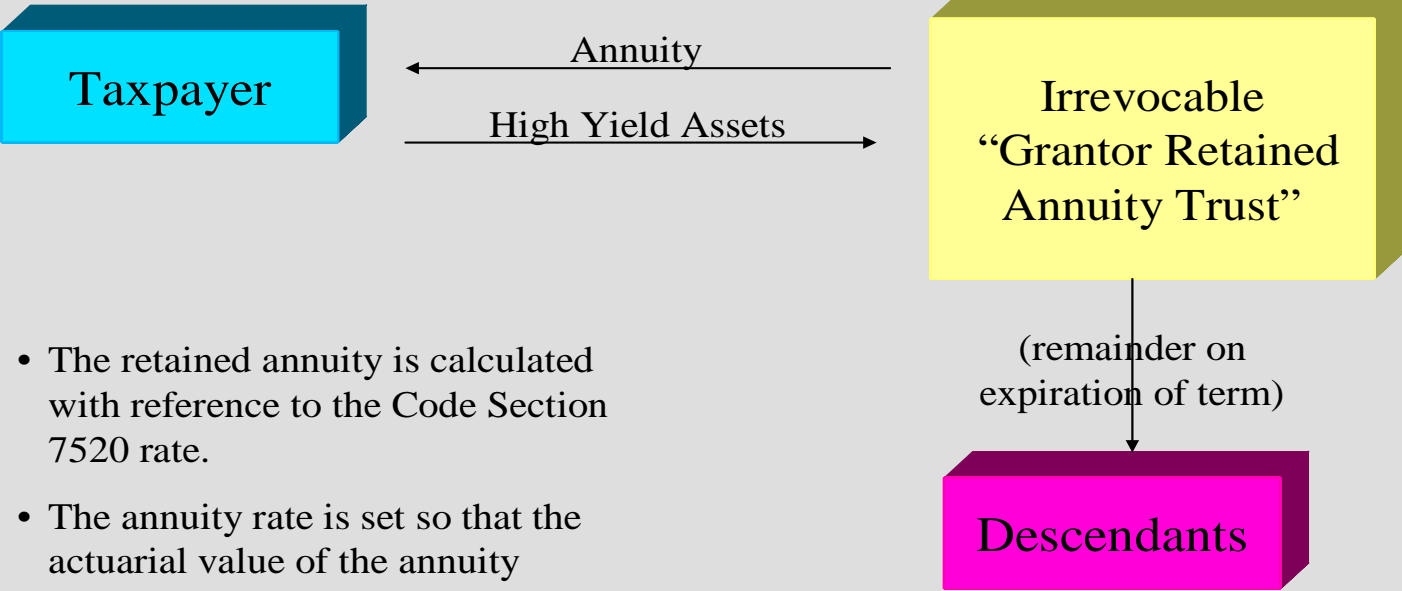
## Grantor Retained Annuity Trusts (GRATs)

- GRAT is a trust established by grantor where grantor receives back annuity payment for life or a term of years and remainder passes to beneficiaries
- Low interest rates have made GRATs very effective as wealth-shifting technique
- If proposed grantor trust law passes, the remainder at end of GRAT term would be subject to gift tax, which would do away with GRATs as planning technique

## Qualified Personal Residence Trust (QPRT)

- Proposed rules would also eliminate QPRT planning for residences

# Grantor Retained Annuity Trust



- The retained annuity is calculated with reference to the Code Section 7520 rate.
- The annuity rate is set so that the actuarial value of the annuity approximates the value of the assets transferred to the irrevocable trust.
- If the assets experience a return in excess of the Code Section 7520 rate, growth is shifted to the irrevocable trust.

## Valuation Rules for Non-business Assets

- Common estate planning strategy has been to transfer closely held investment, real estate and business assets to family limited partnerships or family limited liability companies
- Gifts of limited partners or minority interests can be made for significant valuation discounts for lack of marketability and lack of control and discounts apply at death for estate tax purposes
- Proposed legislation would eliminate valuation discounts when valuing non-business assets in a business entity, such as a FLP or FLLC
- Non-business assets presumably would be defined as assets not actively used in conduct of a business – cash, marketable securities, triple net leased real estate, royalty interests, etc.

# Revised Proposal As of October 28, 2021

## The Very Good News – At Least for Now...

- No change to estate and gift tax exemption amounts or rates
- No change to grantor trust rules
- No change to valuation discounts

# What is still in the tax proposals?

- Additional 5% income tax on modified adjusted gross income (MAGI) for individuals in excess of \$10 million (single or married filing jointly) and in excess of \$200,000 for estates and non-grantor trusts
- Extra additional 3% on MAGI for income in excess of \$25 million (single or married filing jointly) and for estates and non-grantor trusts in excess of \$500,000



## Revised Proposal as of October 28, 2021

- No change to C corporation tax rates
- No changes to 20% qualified business income deduction under 199A
- 3.8% surtax on active business income from passthrough entities (S corps, partnership) for excess income over \$400,000 (single) and \$500,000 married filing jointly – whereas current 3.8% net investment income tax only applies to passive income
- Proposed changes all effective for tax years beginning after December 31, 2021 – no retroactivity

## What Else Do Proposals Leave In/Out?

- Not included - doing away with step-up in basis for income tax purposes at death
- Latest proposal does not include higher tax rates on corporations, wealthy individuals and millionaire investors
- Latest proposal does not include IRS bank reporting requirements
- Latest proposal rejects “billionaire” tax
- Includes ramped up enforcement at the IRS with \$80 billion infusion for IRS (IRS budget is currently about \$12 billion)
- Includes overhaul of international tax code – minimum global tax rate of 15%
- Includes 15% corporate minimum tax imposed on “book” income for corporations with profits over \$1 billion, effective for tax years after December 31, 2022

## What Else Do Proposals Leave In/Out?

- Broadens the application of 3.8% net investment income tax to active business income for pass-through entities with trade or business income over \$400,000 (single) and \$500,000 (joint), and \$12,500 for estates and non-grantor trusts
- Leaves out changes banning Roth IRA conversions for high income taxpayers
- Creates a 1% excise tax on net stock buybacks by corporations
- No changes to long term capital gains rates – proposal was to increase rate from 20% to 25% for single filers earning more than \$400,000 or married filers earning more than \$450,000
- Increases in top income tax rates likely “out”

# What Now?

In the wise words of Yogi Berra in the 1973 pennant race:

“It ain’t over till it’s over”

# Questions?

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